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Profitability Rises For All Firm Categories In 1H 1985

Highlights

1. A new and comprehensive data series which only recently became available reveal that retail commissions are a much larger proportion of total commissions than previous estimates indicated. In the 1H 1985, retail commissions are estimated to account for 63% of total commissions and institutional commissions, 37%.

2. Based upon the new data series, discount brokers' market share of 1H 1985 estimated retail commissions was 7%. This suggests that earlier estimates of discounters' market share were probably too high.

3. The industry's annualized after-tax return-on-equity (ROE) for the first nine months of 1985 was 14%. However, since market conditions were extremely strong in 4Q 1985, we estimate that the after-tax ROE for all of 1985 will be about 16%-18%.

4. Profitability in 1H 1985 rose for all firm categories compared with 1984 when ROE for some categories plunged to levels not experienced since 1974. The annualized 1H 1985 after-tax ROEs by firm category were: Large Investment Banks, 21%; N.Y.C. Based Regionals, 17%; Regionals Based Outside N.Y.C., 16%; Discounters, 12%; and National Full-Line, 10%.

5. The Large Investment Banks' proportion of aggregate underwriting revenue rose to 33% from 27% in 1984 while Regionals Based Outside N.Y.C. retained their market shares of commissions and underwriting revenue in 1H 1985.

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INTRODUCTION

This Trends issue analyzes profitability performance by firm category in 1H 1985 and discusses briefly the industry's 3Q 1985 after-tax return-on-equity (ROE) which just became available. In addition, 1H 1985 estimates of retail commissions are presented, based upon a new and comprehensive data series which only recently was developed from industry sources. Importantly, the new data series reveal that retail commissions are a much larger proportion of total commissions than were previously estimated relying on proxies based on volume.

Unfortunately, data on performance by firm category through the first nine months of 1985 are still not available. This Trends issue furnishes firm category analyses to those who depend on this publication for information on historical trends and to provide the new and more accurate estimate of retail commissions.

Profitability in the 1H 1985 rose for all firm categories compared with 1984 when ROE for some categories plunged to levels not experienced since 1974 (Table 1). In 1H 1985, revenues increased partly because of the more encouraging economic environment in which interest rates declined with indications that rates would remain within a narrow range. In addition, cost containment policies instituted earlier by many firms were becoming effective and contributed to higher profit margins.

Table 1

After-Tax Return-on-Equity[1/]

Firm Categories	1984	Annualized 1H 1985	Change in Percentage Points, 1984-Annal. 1H1985
National Full-Line	(2.4)% [2/]	9.8%	12.2
Large Investment Banks	16.8	20.8	4.0
N.Y.C. Based Regionals	10.8	16.9	6.1
Regionals	3.7	15.5	11.8
Discounters[3/]	(2.4) [2/]	12.3	14.7
Industry	7.2%	16.4%	9.2

1/For NYSE firms doing a public business.

2/Pre-tax ROE

3/NYSE and NASD discounters

( ) Negative
Source: Securities Industry Database

Large Investment Banks (LIBs) were once again the most profitable firm category with an after-tax return-on-equity of 21%. New York City Based Regionals (NYCs) had the second highest after-tax ROE, 17%. The ROEs of the other three firm categories increased the most in 1H 1985 although their levels were still below those of LIBs and NYCs. The 1H 1985 after-tax ROEs of these three categories were: Regionals Based Outside of NYC (REGs), nearly 16%; Discounters (DIS), 12%; and National-Full-Line (NFLs), almost 10%. Compared with 1984, 1H 1985 ROE levels were more uniform and pre-tax income more evenly distributed among the different industry segments.

In the 1H 1985, there were some prominent changes in revenues among the firm categories. For NFLs, trading profits once again exceeded commissions, sales of mutual funds substantially raised revenues, while a drop occurred in their market share of industry underwriting revenue. LIBs' increase in total revenue was below those enjoyed by the other firm categories. Nevertheless, their share of industry underwriting revenue continued to rise. REGs' revenue growth was enhanced by the jump in mutual fund sales while their market shares of commissions and underwriting revenue were retained. NYCs' proportion of industry commissions rose while LIBs' declined because of the plunge in institutional commission rates.

Firm Categories

National Full-Line

Introduction

After suffering losses in 1984, the National Full-Line (NFLs) firm category was profitable in 1H 1985 because of significant increases in revenues from both agency and principal businesses, as well as cost controls implemented earlier. Annualized after-tax ROE was 10% in 1H 1985. Total revenue went up by an annualized 21% compared to expenses which rose by 13% (Table 2). Proximate non-interest revenue[1/] climbed 27% while non-interest expense increased only 16%.

Although NFLs' ROE rose in the 1H 1985, this remained the least profitable firm category mainly because of its comparatively low profit margin (Table 3). Their 1H 1985 pre-tax profit margin was less than 6% compared with the overall industry's 11%.

Revenues

Proximate non-interest revenue rose primarily because of increases in trading profits, commissions and mutual fund sales. These three sources were responsible for 98% of the jump in proximate non-interest revenue.

1/ A comparison of proximate non-interest revenue and non-interest expense helps to better understand the reasons for the change in profitability by minimizing the effects of interest rate trends on revenues and expenses.

Table 2

National Full-Line Firms
Revenues and Expenses, 1984 and 1H 1985 1/
(millions of dollars)

	1984	1H 1985	
		Actual	Annualized
REVENUES			
Commissions	$2,936	$1,781.6	$3,563.2
Listed equities on an exchange	2,163	1,344.4	2,688.8
Listed equities, OTC	30	10.2	20.4
Options	478	255.3	510.6
All Other	265	171.6	343.2
Trading Profits	3,038	2,189.3	4,378.6
Market Making - OTC equity	526	374.7	749.4
Debt Securities	2,338	1,690.1	3,380.2
Options on Nat'l Exchange	3	2.3	4.6
All Other	170	122.0	244.0
Investment Profits	110	48.2	96.4
Underwriting	1,457	814.4	1,628.8
Margin Interest	1,547	657.0	1,314.0
Mutual Fund Sales	550	579.3	1,158.6
Account Supervision	285	179.9	359.8
Research	(1)	0	0
Commodities	608	310.8	621.6
Other-Related	1,979	1,150.0	2,300.0
Other-Unrelated	560	175.7	351.4
TOTAL REVENUE	$13,066	$7,886.1	$15,772.2
EXPENSES			
Employment	$5,976	$3,589.4	$7,178.8
RR Compensation	3,246	2,023.7	4,047.4
Clerical & Administrative	2,730	1,565.7	3,131.4
Floor Brokerage & Clearance	347	201.7	403.4
Fixed Expense	2,124	1,158.9	2,317.8
Communications	1,066	572.8	1,145.6
Occupancy & Equipment	861	498.5	997.0
EDP Equipment	197	87.6	175.2
Promotional Costs	459	219.0	438.0
Interest Expense	2,822	1,443.3	2,866.6
Errors & Bad Debt	145	79.4	158.8
Non-recurring Charges	10	3.2	6.4
Partners & Stockholders	191	113.7	227.4
Regulatory Fees & Expenses	49	48.4	96.8
Other Expenses	1,063	591.8	1,183.6
TOTAL EXPENSE	$13,184	$7,448.7	$14,897.4
PRE-TAX NET INCOME	$(118)	$437.4	$874.8

1/Discrepancies may exist due to rounding.
( ) Negative
Source: Securities Industry Database

Table 3

Component Analysis of After-Tax Return on Equity

Firm Categories		Profit Margin ($)	x	Asset Turnover ($)	x	Leverage	x	Tax Retention Rate (%)	=	ROE (%)
Nat'l Full Line	1982	.0881		.2681		12.6		54.0%		16.1%
	1983	.0858		.2400		13.7		54.0		15.2
	1984	(.0083)		.1787		16.0		-		(2.4) 1/
	1H85 2/	.0555		.1875		17.4		54.0		9.8
Lg. Invst. Bks.	1982	.1736		.1045		30.2		54.0		29.6
	1983	.1673		.0872		30.0		54.0		23.7
	1984	.1144		.0837		32.5		54.0		16.8
	1H85 2/	.1459		.0768		34.4		54.0		20.8
New York Based	1982	.1403		.2257		13.7		54.0		23.4
	1983	.1834		.2267		12.2		54.0		27.3
	1984	.0886		.1779		12.7		54.0		10.8
	1H85 2/	.1245		.1881		13.3		54.0		16.9
Regional	1982	.1108		.3439		9.4		54.0		19.4
	1983	.1265		.4083		7.8		54.0		21.9
	1984	.0259		.3235		8.1		54.0		3.7
	1H85 2/	.0947		.3759		8.1		54.0		15.5
Discounters 3/	1982	.1360		.4932		7.30		54.0		26.4
	1983	.1396		.5005		6.69		54.0		25.2
	1984	.0034		.3873		6.48		54.0		0.5
	1H85 2/	.0721		.3610		7.91		54.0		11.1
Industry	1982	.1308		.1787		17.3		54.0		21.9
	1983	.1294		.1631		17.3		54.0		19.8
	1984	.0515		.1348		19.1		54.0		7.2
	1H85 2/	.1101		.1345		20.5		54.0		16.4

1/ Pre-tax ROE
2/ 1H 1985 data are annualized.
3/ NYSE Discounters
( ) Negative
Source: Securities Industry Database

Trading profits climbed by an annualized 44% in the 1H 1985, to $4.4 billion, and accounted for 51% of the rise in proximate non-interest revenue. Improved markets for debt securities and OTC stocks were responsible for almost all of the rise in trading profits. Trading profits in debt securities climbed an annualized 45%, to $3.4 billion, which accounted for nearly 80% of the jump in trading profits. Market-making OTC increased 42%, to $750 million, explaining 17% of the ascent in trading profits.

The 1979 to 1984 compound annual growth rate of trading profits was 28%, compared to the 22% rise for proximate non-interest revenue. As a result, trading profits became NFLs' largest revenue source by 1984 accounting for 23% of total revenue. In 1H 1985, its proportion of total revenue rose to 28%.

Commissions increased an annualized 21% in 1H 1985, to $3.6 billion, and accounted for 24% of the rise in proximate non-interest revenue. Nevertheless, commissions have not grown relative to 1983 as annualized 1H 1985 commissions were still slightly below their 1983 level primarily because of a drop in average commission rates. On the registered stock exchanges, average daily share volume in 1H 1985 was 21% higher than in 1983 and 1H 1985 annualized dollar value of shares traded was 24% higher than in 1983.

The most dramatic change in 1H 1985 NFLs' revenue sources was commissions from mutual fund sales which jumped by an annualized 107% to nearly $1.2 billion. Importantly, this climb raised proximate non-interest revenue by 23%, significantly more than all other revenue sources except trading profits and commissions. Total mutual fund sales soared to $46.2 billion in 1H 1985 compared with $45.8 billion for all of 1984.

Underwriting revenue, NFLs' third largest non-interest revenue source, increased an annualized 12%. However, this rise was considerably below the industry's 26% climb.

The comparatively small 1H 1985 increase in NFLs' underwriting revenue occurred largely because of a decline in their share of corporate debt underwriting volume. In 1984, based on full credit given to book manager, NFLs' proportion of both corporate debt underwriting volume and total corporate underwriting volume was 39%.[2/] Also, NFLs' proportion of industry underwriting revenue amounted to 54% in 1984, a relatively large share compared with the 1979-1983 average of 47% (Table 4). One firm, dominant in the fast-growing high-yield bond market, contributed significantly to this category's increase in debt underwriting volume. The magnitude of takeover deals done via public debt offering programs declined in 1H 1985. As a result, the NFLs' share of debt underwriting volume and total corporate underwriting volume fell to 29% and 33%, respectively.

2/ IDD Information Services, Inc.

Table 4

Market Shares of Total Underwriting Revenues by Firm Category

	1979	1980	1981	1982	1983	1984	1H 1985
NFL	43.6%	47.8%	45.9%	54.1%	45.0%	53.8%	47.7%
LIB	25.6	25.0	23.6	24.2	29.7	27.1	32.6
REG	NA	NA	NA	16.0	17.8	14.6	14.3
NYC	NA	NA	NA	3.1	2.5	1.3	1.6
Other	NA	NA	NA	2.6	5.0	3.2	3.9
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

NA Not available
Source: Securities Industry Database

Expenses

NFLs' expenses rose modestly in the 1H 1985 as the impact of earlier cost control policies in 1984 was felt. Most of the increases in expenses resulted from higher employment costs related to increased production. Overall, annualized 1H 1985 expenses rose only 13% while revenues increased by 21%.

Higher employment costs were responsible for 73% of the 1H 1985 rise in non-interest expense. RR compensation increased 25% because of increased production and accounted for 49% of the rise in non-interest expense. Average RR employment rose to 48,000 in the 1H 1985 from 46,000 in 1984, a 4% increase. Clerical and administrative employee expenses went up by an annualized 15%.

The positive results of the cost controls policies instituted in 1984 were clearly seen in the very modest 9% 1H 1985 annualized increase in so-called fixed expense. The compound annual increase in such expenses was 29% from 1979-1984. On an annualized basis, EDP equipment costs fell by 11%, communications expense rose less than 8% and occupancy & equipment increased 16%.

Large Investment Banks[3/]

Introduction

Large Investment Banks (LIBs) were once again the most profitable firm category in 1H 1985 with an annualized after-tax ROE of 21%. Annualized 1H 1985 total revenue rose a modest 11% while expenses went up by 7% (Table 5). As a result, annualized pre-tax profit margin improved to almost 15%.

Revenues

Three sources were responsible for almost all of the growth in annualized 1H 1985 proximate non-interest revenue: commodities; underwriting; and trading profits.[4/] Commissions and mutual fund sales contributed very little to the increase.

Trading profits were the largest revenue source for LIBs. However, despite very favorable 1H 1985 market conditions, such revenue rose only by a reported 7%. This occurred because of the reported small rise in trading profits from debt securities and the drop in "other."[5/] As a result, trading profits accounted for 19% of LIBs' 1H 1985 growth in proximate non-interest revenue.

[3/] Lehman Brothers, an LIB firm, was acquired by Shearson/American Express, an NFL firm, in 1984. Lehman Brothers essentially stopped doing business in 2Q 1984 and its proportions of the LIBs' 1984 total revenue, total expense and income were insignificant in that year. Consequently, the inclusion of Lehman Brothers in the LIBs' 1984 data does not affect this category's 1H 1985 analysis relative to 1984.

[4/] We believe that trading profits for LIBs may have been understated while the reported climb in commodities revenue may be overstated. Some of the revenue reported under commodities may belong in trading profits.

[5/] LIBs' trading profits in debt securities increased a reported 10%, significantly below the rest-of-the industry's 44% climb. The rest-of-the industry's 1H 1985 percent changes in long positions and short positions were similar to those for LIBs. So this does not explain the "weak" relative rise in trading profits for the LIB category.

Commodities revenue climbed by a reported 550% which accounted for 29% of the 1H 1985 rise in proximate non-interest revenue.

We believe that there may be some reporting problems for this firm category. For the rest-of-the industry, commodities revenue rose only 2% while trading profits jumped by 41%. We have been in touch with the self-regulators about these concerns.

Table 5

Large Investment Banks
Revenues and Expenses, 1984 and 1H 1985 1/
(millions of dollars)

	1984	1H 1985	
		Actual	Annualized
REVENUES			
Commissions	$1,068	$573.3	$1146.6
Listed equities on an exchange	915	496.0	992.0
Listed equities, OTC	2	1.5	3.0
Options	70	38.3	76.6
All Other	81	37.5	75.0
Trading Profits	3,397	1,822.5	3,644.0
Market Making - OTC equity	119	85.0	170.0
Debt Securities	2,702	1,480.0	2,960.0
Options on Nat'l Exchange	(3)	54.2	108.4
All Other	580	202.9	405.8
Investment Profits	364	219.7	439.4
Underwriting	734	557.6	1,115.2
Margin Interest	385	172.8	345.6
Mutual Fund Sales	11	12.3	24.6
Account Supervision	111	62.7	125.4
Research	0 2/	.2	.4
Commodities	65	212.3	424.6
Other-Related	3,327	1,603.0	3,206.0
Other-Unrelated	640	386.6	773.2
TOTAL REVENUE	$10,103	$5,622.5	$11,245.0
EXPENSES			
Employment	$1,926	$1,155.1	$2,310.2
RR Compensation	786	500.5	1001.0
Clerical & Administrative	1,140	654.6	1,309.2
Floor Brokerage & Clearance	216	108.2	216.4
Fixed Expense	605	348.5	697.0
Communications	261	136.7	273.4
Occupancy & Equipment	259	150.3	300.6
EDP Equipment	85	61.5	123.0
Promotional Costs	140	75.3	150.6
Interest Expense	5,318	2,595.9	5,191.8
Errors & Bad Debt	21	12.6	25.2
Non-recurring Charges	0 2/	0.0	0.0
Partners & Stockholders	301	197.6	395.2
Regulatory Fees & Expenses	28	15.9	31.8
Other Expenses	394	293.1	586.2
TOTAL EXPENSE	$8,948	$4,802.2	$9,604.4
PRE-TAX NET INCOME	$1,155	$820.4	$1,640.8

1/Discrepancies may exist due to rounding.

2/Less than $500,000.

( ) Negative
Source: Securities Industry Database

LIBs' underwriting revenue climbed an annualized 52% in 1H 1985 which raised proximate non-interest revenue by nearly 29%. Their proportion of industry underwriting revenue rose to nearly 33% in 1H 1985 from 27% in 1984. LIBs' share of total corporate underwriting volume, based upon full credit given to the book manager, was almost 63% in 1H 1985 compared to less than 58% in 1984.6/ This rise was in both debt and equity offerings. Their proportion of long-term municipal underwriting volume, based upon full credit given to the lead manager, remained at about 23% in 1H 1985.7/

Commissions, LIBs' second largest non-interest revenue source, rose by an annualized 7% in 1H 1985 largely because of a decrease in the average institutional commission rate. Of LIBs' total revenue, commissions were only 10% in 1H 1985.

Revenue from mutual fund sales increased an annualized 124%. However, such revenues raised proximate non-interest revenue by only 1%. Mutual funds are basically a retail product and LIBs emphasize institutional and principal businesses.

Expenses

LIBs' non-interest expense rose an annualized 22% in 1H 1985, significanlty more than rest-of-the industry's 14% increase. Higher expense levels for employment, other, partners & stockholders and so-called fixed expense explain this category's climb in non-interest expense.

Higher employment costs accounted for 49% of the rise in 1H 1985 annualized non-interest expense. The rise in RR compensation explained almost 27% of this increase while higher clerical and administrative employee expense was responsible for 22%. Most of this resulted because of increased productivity as average total employment rose by only 3%.

So-called fixed expense increased 15% which was responsible for 12% of the rise in annualized non-interest expense. Communications expense went up by 5%, occupancy & equipment rose by 16% but EDP equipment costs climbed by a dramatic 45%. Apparently, LIBs' EDP equipment costs rose significantly to increase capacity and change systems to handle higher volume, especially in the fixed income area.8/

6/IDD Information Services, Inc.

7/Public Securities Association, "The Municipal Securities Market First Half of 1985."

8/Higher "other" expenses accounted for 25% of 1H 1985 annualized rise in LIBs' non-interest expense while the rise in partners & stockholders costs were responsible for 12%.

Regionals

Introduction

Regionals' (REGs') annualized after-tax ROE rose significantly in the 1H 1985 to almost 16% after dropping to 4% in 1984. This occurred as retail agency business improved and revenue from principal activities increased. In addition, expenses were constrained as REG firms' cost containment policies were very effective.

REGs' annualized 1H 1985 total revenue increased 18% while total expense went up by just 9% (Table 6). Proximate non-interest revenue climbed 27% and non-interest expense rose 13%. As a result, significant 1H 1985 increases took place in their profit margin which rose to more than 9% from less than 3% in 1984.

Revenues

The four revenue sources which were responsible for almost all of the industry's 1H 1985 growth in proximate non-interest revenue also accounted for most of the improvement in REGs' proximate non-interest revenue. Increases in trading profits, commissions, mutual fund sales and underwriting explain 93% of the 1H 1985 rise in proximate non-interest revenue.

Trading profits climbed an annualized 37% in 1H 1985 and were responsible for 30% of the rise in proximate non-interest revenue. The decline in interest rates resulted in trading profits in debt securities increasing by an annualized 34%. The NASDAQ Composite Index rose to 296 at the end of 1H 1985, a 20% increase from year-end 1984, which aided in a 42% climb in OTC market-making profits.

Commissions rose by nearly 15%, to $1.3 billion, because of the improvement in retail agency business. This accounted for 26% of the increase in proximate non-interest revenue.

REGs benefited from investors' increased interest in equities and long-term government bond mutual funds. Revenue from mutual fund sales soared by an annualized 93%, to $310 million, which accounted for 23% of the rise in proximate non-interest revenue. This 1H 1985 revenue climb was larger in absolute terms than from all other revenue sources except trading profits and commissions. In fact, the annualized rise in revenue from mutual fund sales, $149 million, was nearly equal to that from commissions, $170 million.

During the 1H 1985, underwriting revenue for REG firms was clearly boosted by the boom in municipal volume which increased at a pace exceeding the 1984 record. Offsetting this favorable development has been the increased proportion of corporate securities not distributed through syndicates or using smaller syndicates.

Table 6

Regional Firms
Revenues and Expenses, 1984 and 1H 1985 1/
(millions of dollars)

	1984	1H 1985	
		Actual	Annualized
REVENUES			
Commissions	$1,176	$673.1	$1,346.2
Listed equities on an exchange	729	416.0	832.0
Listed equities, OTC	12	7.0	14.0
Options	129	69.5	139.0
All Other	306	180.6	361.2
Trading Profits	530	362.8	725.6
Market Making - OTC equity	174	123.4	246.8
Debt Securities	296	198.9	397.8
Options on Nat'l Exchange	1	0.3	0.6
All Other	63	40.8	81.6
Investment Profits	17	29.5	59.0
Underwriting	396	244.7	489.4
Margin Interest	400	140.5	281.0
Mutual Fund Sales	161	155.0	310.0
Account Supervision	44	27.2	54.4
Research	6	2.2	4.4
Commodities	41	19.1	38.2
Other-Related	410	222.4	444.8
Other-Unrelated	58	28.5	57.0
TOTAL REVENUE	$3,240	$1,905.0	$3,810.0
EXPENSES			
Employment	$1,452	$851.5	$1,703.0
RR Compensation	847	522.1	1,044.2
Clerical & Administrative	605	329.4	658.8
Floor Brokerage & Clearance	166	95.6	191.2
Fixed Expense	512	267.9	535.8
Communications	262	129.8	259.6
Occupancy & Equipment	197	106.3	212.6
EDP Equipment	55	31.8	63.6
Promotional Costs	98	49.0	98.0
Interest Expense	424	178.9	357.8
Errors & Bad Debt	23	11.3	22.6
Non-recurring Charges	12	1.9	3.8
Partners & Stockholders	221	132.7	265.4
Regulatory Fees & Expenses	29	15.9	31.8
Other Expenses	215	119.4	238.8
TOTAL EXPENSE	$3,155	$1,724.6	$3,449.2
PRE-TAX NET INCOME	$84	$130.4	$360.8

1/Discrepancies may exist due to rounding.
Source: Securities Industry Database

Expenses

Non-interest expense rose relatively less for REGs than the rest-of-the industry. For example, the difference between the increase in proximate non-interest revenue and non-interest expense was 14 percentage points for REGs compared with 8 percentage points for the rest-of-the industry.

Employment expense rose with higher production and was responsible for 70% of the rise in non-interest expense. RR compensation went up by 23% despite the average number of RRs declining 2%, to 15,130 from 15,465 in 1984. Excluding RRs, the number of other employees decreased 4%, to 19,925 from 20,715 in 1984.

At 5%, REGs' annualized 1H 1985 rise in so-called fixed expense was lower than any other firm category. Communications decreased an annualized 1%, occupancy & equipment expenses increased 8% and EDP costs rose 16%.. For the rest-of-the industry, so-called fixed expense went up 11%.

New York City Regionals

Introduction

NYC regional firms' (NYCs') annualized after-tax ROE rose to 17% in the 1H 1985 after dropping to 11% in 1984. While total revenue increased an annualized 17%, total expense rose 13% (Table 7). NYCs' revenue growth was as strong as the rest-of-the industry, however, their expenses rose more substantially. Unlike most of the other firm categories, NYC regionals apparently did not institute cost containment policies if increased expenditures on technology are any guide to overall policy. Nevertheless, this was the second most profitable firm category which has been the general trend since 1974.

Revenues

The sources spurring NYCs' 1H 1985 revenue growth differed somwhat from those that contributed to the overall industry's rise. Three revenue sources - commissions, trading profits and account supervision were responsible for almost all of the 1H 1985 annualized growth in proximate non-interest revenue. Unlike the rest-of-the industry, commissions and account supervision were more important while mutual fund sales and underwriting were less important. Compared to the rest-of-the industry, NYC regionals are more orientated towards agency business, both institutional and retail, as well as money management.

Commissions climbed an annualized 28% in the 1H 1985, significantly higher than the rest-of-the industry's increase of less than 16%. Commission growth was responsible for 64% of the rise in NYCs proximate non-interest revenue.

Table 7

New York Regional Firms
Revenues and Expenses, 1984 and 1H 1985 1/
(millions of dollars)

	1984	1H 1985	
		Actual	Annualized
REVENUES			
Commissions	$681	$435.7	$871.4
Listed equities on an exchange	508	323.8	647.6
Listed equities, OTC	18	14.0	28.0
Options	47	30.6.	61.2
All Other	108	67.2	134.4
Trading Profits	206	168.4	336.8
Market Making - OTC equity	32	30.1	60.2
Debt Securities	113	89.7	179.4
Options on Nat'l Exchange	19	3.7	7.4
All Other	42	44.9	89.8
Investment Profits	63	20.1	40.2
Underwriting	34	28.0	56.0
Margin Interest	230	96.9	193.8
Mutual Fund Sales	9	12.9	25.8
Account Supervision	115	74.8	149.6
Research	3	1.0	2.0
Commodities	17	7.5	15.0
Other-Related	241	138.3	276.6
Other-Unrelated	107	17.8	35.6
TOTAL REVENUE	$1,705	$1,001.5	$2,003.0
EXPENSES			
Employment	$586	$368.2	$736.4
RR Compensation	264	178.1	356.2
Clerical & Administrative	322	190.1	380.2
Floor Brokerage & Clearance	140	89.6	179.2
Fixed Expense	201	121.6	243.2
Communications	86	54.0	108.0
Occupancy & Equipment	86	52.6	105.2
EDP Equipment	27	15.0	30.0
Promotional Costs	35	19.9	39.8
Interest Expense	347	128.0	256.0
Errors & Bad Debt	9	6.4	12.8
Non-recurring Charges	4	3.4	6.8
Partners & Stockholders	84	43.3	86.6
Regulatory Fees & Expenses	13	8.9	17.8
Other Expenses	137	75.6	151.2
TOTAL EXPENSE	$1,554	$876.8	$1,753.6
PRE-TAX NET INCOME	$151	$124.7	$249.4

1/Discrepancies may exist due to rounding.
Source: Securities Industry Database

NYC trading profits rose an annualized 63% in 1H 1985, significantly higher than the 26% increase experienced by the rest-of-the industry. Like the rest-of-the industry, trading profits in debt securities was responsible for the most significant increase in trading profits, 51%. Unlike the rest-of-the industry, "other" accounted for the second largest rise.

Fees for supervision and advisory services were much more important to NYCs' 1H 1985 annualized growth than for other industry segments. NYCs are relatively more heavily involved in money management than the rest-of-the industry. In 1H 1985, such fees raised NYCs annualized proximate non-interest revenue by 12% compared to less than 2% for the rest-of-the industry.

Underwriting revenue increased an annualized 64% in 1H 1985, to $56 million, raising proximate non-interest revenue by 7%. For NYC regionals, underwriting is not as significant a revenue source as for the rest-of-the industry, accounting for about 3% of proximate non-interest revenue in both 1984 and 1H 1985.

Expenses

Expenses increased more for NYC regionals in 1H 1985 than the rest-of-the industry largely because of revenue growth. NYCs' profit margin rose to 12% from about 9% in 1984, the second highest among the firm categories in both periods. Nevertheless, NYCs did not institute cost containment programs as most of the firm categories had to do. So-called fixed expense climbed significantly faster for NYCs while they rose relatively modestly for the rest-of-the industry.

Employment expense (RR and clerical & administrative) increased an annualized 26% largely because of higher production and accounted for 52% of the 1H 1985 rise in non-interest expense. Total employment increased less than 7% in 1H 1985, to 12,545 from 11,715 in 1984.

NYCs so-called fixed expense climbed an annualized 21% in the 1H 1985 compared to a modest 9% for the rest-of-the industry. Nevertheless, so-called fixed expense was a smaller proportion of 1H 1985 NYCs' non-interest expense, 14%, than for the rest-of-the industry, nearly 18%. Communications expense climbed by 26% which accounted for 52% of the 1H 1985 jump in so-called fixed expense. From 1982 to 1984, the compound annual growth rate for communications was only 6%. Apparently, NYCs increased their 1H 1985 communications expenditure by incorporating new technology for competitive reasons. Occupancy & equipment also rose significantly, 22%, and was responsible for 45% of the higher 1H 1985 so-called fixed expense. Since 1982, occupancy & equipment costs have been increasing at a rapid 31% compound annual rate reflecting higher rental costs and expanding facilities.

Discounters

Introduction

Included in this analysis of discounters (DIS) 1H 1985

profitability performance are members of both the NYSE and NASD. In 1H 1985, discounters who were sole members of NASD accounted for: 23% of revenues and expenses; 21% of commissions; and 26% of pre-tax income of all discounters.

DIS returned to profitability in 1H 1985 as retail investors' interest in equities improved because of more favorable market conditions. In 1H 1985, NYSE average daily share volume climbed 18% and the NYSE Composite Index rose 15%. DIS' total revenue increased an annualized 19% while total expense went up by less than 10%. Proximate non-interest revenue climbed 25% and non-interest expense rose less than 11%. As a result, annualized 1H 1985 after-tax ROE rose to 12% compared with a 1984 pre-tax ROE of (2)%. Still, DIS' 1H 1985 profitability was low relative to most other firm categories and compared with an after-tax ROE of 23% in 1982 and 22% in 1983.

Revenues[9/]

DIS' non-interest revenue was essentially derived from commissions which accounted for 87% of 1H 1985 proximate non-interest revenue. For the rest-of-the industry, commissions amounted to 29% of proximate non-interest revenue.

DIS commissions climbed by an annualized 23%, significantly greater than the rest-of-the industry's 16% increase. This occurred because retail activity rose substantially in 1H 1985 from its depressed 1984 level. Also, retail commission rates were not under the same severe price pressures as institutional rates. The climb in commissions accounted for 83% of the 1H 1985 increase in DIS proximate non-interest revenue.

Market Share

DIS' 1H 1985 market share of estimated retail commissions was determined based upon our new data series which generates excellent information on volume from the largest institutions. These new data yield more accurate estimates of retail commissions than prior methods utilized by various analysts. Previously, all analysts were forced to estimate retail commissions' proportion of total commissions by utilizing various data on different market proxies. Additional weaknesses were that it did not allow for changes in average retail and institutional commission rates over time.

The new estimating method relies on comprehensive share volume data from broker/dealers and includes share volume data from the largest institutions on the NYSE, AMEX, and NASDAQ. These new data series first became available to SIA in May 1985. Professional institution share volume is obtained from a comprehensive universe of reporting broker-dealers (1,084) and participating institutions (4,980). Share volume is reported for all deliver-versus-payment

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9/ The analysis of revenues and expenses is based solely upon NYSE DIS data.

(DVP) transactions and receive-versus-payment (RVP) transactions. Member trading share volume is supplied separately in weekly reports by the NYSE and AMEX. Retail share volume is obtained as a residual.10/

NYSE and AMEX retail share volume along with the estimated average retail commission rate yields an estimate for retail commissions on these exchanges which are combined to estimate industry retail commissions. The same approach is used to estimate institutional commissions on these exchanges.

The 1H 1985 proportion of publicly traded share volume from retail accounts on the NYSE was estimated at 32% and 53% on AMEX.11/ Consequently, professional institution's proportion of publicly traded share volume on the NYSE was estimated at 68% and 47% on AMEX. The average retail commission in the 1H 1985 was estimated to be $.27 per share and the average professional institution commission was estimated at $.08 per share. These averages were based upon an informal survey of securities firms and securities analysts.

Estimates from this analysis show that of total 1H 1985 commissions, 63% was retail and 37% institutional. As a result, DIS' market share of 1H 1985 retail commissions was 7% (Table 8). Comparisons with prior years are inappropriate since the new data series only became available in the 2Q 1985.

10/For a more detailed analysis of these new data series see Schaefer, Jeffrey, "Introducing SIA's Investor Activity Report," Trends, July 31, 1985.

11/On the NYSE and AMEX, retail share volumes' preliminary proportions of publicly traded share volumes (excludes member trading) averaged 39% and 64%, respectively, from May to October 1985. The monthly fluctuations on both exchanges were within a fairly narrow range. These averages were used to estimate retail share volume for the 1H 1985. Each of these averages was lowered 17% because some professional institution share volume is not reported in DVP or RVP transactions. This 17% adjustment was determined based upon input from equity professionals. The proportion of publicly traded share volume from professional institutions was 68% and 47% on the NYSE and AMEX, respectively after adjustment. Combined with member trading as principals, institutions and brokers accounted for 76% of volume on the NYSE and AMEX.

Table 8

NYSE and NASD Discounters' Market Share, 1H 1985
(millions of dollars)

	Actual Dollars
Industry Commissions	$4,139.2
Estimated Retail Commissions	2,611.8
Discounters' Commissions	182.2
Discounters' Market Share of Retail Commissions	7.0%
Industry Gross Revenue	$18,178.1
Discounters' Gross Revenue	274.3
Discounters' Market Share of Gross Revenue	1.5%

Expenses

DIS non-interest expense rose by an annualized 11% in 1H 1985. Employment expense rose less for DIS, 16%, than NFLs, 20%, but about the same as REGs, 17%. This occurred even though average employment rose slightly more for DIS, 3%, than for NFLs, 2%, and REGs, (2)%.

DIS so-called fixed expense increased an annualized 15%, significantly more than for NFLs, 9%, and REGs, 5%. Furthermore, each of the three items in so-called fixed expense rose more for DIS than for these other categories. In 1H 1985, DIS communications expense increased 10%, occupancy & equipment 19% and EDP equipment costs 17%. The 1982 to 1H 1985 annualized compound annual growth rate for DIS so-called fixed expense has been a rapid 30%, led by occupancy & equipment, 41%, communications, 27%, and EDP equipment costs, 18%.

DIS continued to spend more for promotional activities than the NFLs or REGs. In 1H 1985, such costs climbed an annualized 32% compared with NFL firms' 5% decrease while REG firms' expenditure remained at about the 1984 level. Promotional expense's 1982 to 1H 1985 annualized compound annual growth rate was 32% for DIS compared with 10% for NFLs and 9% for REGs.

Industry's 3Q 1985 Profitability Performance

Profitability fell in 3Q 1985 as annualized after-tax ROE was 10% compared with 16% for 1H 1985. This drop occurred largely because interest rates reached their troughs toward the end of 2Q

1985 and rose modestly in 3Q 1985. Total revenue decreased by an annualized 3%, while expenses increased by about 1%.

The lower 3Q 1985 revenue level occurred entirely because of the drop in annualized revenue from three sources: trading profits, $1.2 billion; commissions, $818 million; and investment profits, $603 million. On the expense side, annualized costs went up most substantially for: employment, $243 million; so-called fix expense, $188 million; and non-recurring charges, $102 million.

The 3Q 1985 drop in profitability reduced the industry's annualized after-tax ROE for the first nine months of 1985 to 14%. However, market conditions were extremely strong in the 4Q 1985 because of declining intermediate and long-term interest rates and optimistic expectations that rates could continue to fall due to the G-5 agreement, passage of the Gramm-Rudman amendment and OPEC's new production policy. As a result, the industry's after-tax ROE for all of 1985 should rise to about 16%-18%. This would be a significant improvement compared with 1984 when after-tax ROE was 7%, the least profitable year since 1977.

Ira Epstein
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VOLUME

	NOVEMBER 1985	YEAR-TO-DATE 1985	NOVEMBER 1984	YEAR-TO-DATE 1984	% CHAN. Y-T-D 1985-1984
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	122.3	107.0	83.7	91.3	17.1%
AMEX (MILS.)*	9.1	8.0	6.0	6.0	33.6%
NASDAQ (MILS.)*	92.0	79.2	58.2	59.5	33.2%
REGIONAL EXCHANGE (MILS.)*	N/A	N/A	14.4	14.3	N/A
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	$86,772	$867,706	$57,025	$708,2 .	22.5%
AMEX (MILS.)	2,255	22,869	1,761	18,808	21.6%
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	5,954	71,092	4,515	65,771	8.1%
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	15,483	165,039	13,295	152,611	8.1%
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	51.6%	51.9%	49.2%	50.0%	----
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	13,964	132,562	10,350	1 .451	16.8%
AMEX OPTIONS	3,386	31,914	2,061	30,353	5.1%
COMMODITY	14,022	145,236	12,694	139,608	4.0%

*MONTHLY AVERAGE
N/A - DATA NOT AVAILABLE

YIELDS

(MONTHLY AVERAGES)

	DECEMBER 1985	DECEMBER 1984	BASIS POINT CHG 1985-1984
BOND BUYER INDEX (20 BOND)	8.43%	9.90%	(147)
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	10.16	12.71	(255)
Baa CORPORATE	11.58	14.19	(261)
RATIO Aaa CORPS. TO Baa CORPS.	0.88	0.90	(2)
MUNICIPAL BOND YIELDS (MOODY'S)	8.43	10.10	(167)

PRICES

(END OF MONTH)

	DECEMBER 1985	DECEMBER 1984	% CHAN. Y-T-D 1985-1984
DOW JONES INDUSTRIALS	1546.67	1211.57	27.66%
STANDARD & POOR'S 500	211.28	167.24	26.33%
NYSE COMPOSITE	121.58	96.38	26.15%
AMEX MARKET VALUE INDEX	246.13	204.26	20.50%
VALUE LINE COMPOSITE	214.86	177.98	20.72%
NASDAQ COMPOSITE	324.93	247.35	31.36%

UNDERWRITING

	FULL YEAR 1985	FULL YEAR 1984	% CHANGE FY 1985 - FY 1984
CORPORATE FINANCING (Gross New Issues- Billions)			
Total	138.5	82.4	68.1%
Common Stock	24.8	9.2	169.6
# of Common Stock Issues	746	563	32.5
Preferred Stock	8.6	3.9	120.5
# of Preferred Stock Issues	131	70	87.1
Corporate Debt	105.1	69.3	51.7
# of Corporate Debt Issues	1,347	786	71.4
MUNICIPAL FINANCING (Gross New Issues - Millions)			
Total	$180,380	$132,950	35.7%
Notes	18,860	31,068	(39.3)
Bonds	161,520	101,882	58.5

MARGIN DEBT

	NOVEMBER 1985	NOVEMBER 1984	% CHANGE 1985-1984
MARGIN DEBT OUTSTANDING ($MILS)	26,640	22,350	19.2%
NET CHANGE IN MARGIN DEBT ($MILS)	4,290	560	666.1%
% OF ACCOUNTS WITH EQUITY UNDER 40%	11%	11%	-----

FINANCIAL DATA FOR NYSE FIRMS DOING A PUBLIC BUSINESS
(MILLIONS OF DOLLARS)

	Third Quarter 1985	Yr. -To-Date 1985	First Quarter 1984	Yr. -To-Date 1984	% Change 3rd Q. 1985 3rd Q. 1984	Yr. -To-Date % Change 1985 - 1984
REVENUE						
SECURITIES COMMISSION INCOME	$1,865	$6,012	$1,766	$5,387	5.6%	11.6%
TRADING PROFITS	2,100	6,913	2,005	5,134	4.7	34.7
UNDERWRITING	1,013	2,720	659	1,836	53.7	48.1
TOTAL REVENUE	8,815	27,024	8,324	22,698	5.9	19.1
TOTAL EXPENSES	8,144	24,392	7,632	21,594	6.7	13.0
NET INCOME BEFORE TAXES	671	2,632	692	1,104	(3.0)	138.4
PERCENT OF FIRMS SHOWING LOSS	32.4%	NA	30.9%	NA	---	---

RECENT INTERESTING READING AND STATISTICAL MATERIAL

Item	Description	Source
Survey of Legal and Compliance Departments in the Securities Industry	SIA's inaugural survey on legal and compliance departments. In addition to data on salaries and bonuses, this survey will present information on how compliance departments operate - - their roles within the firm and their philosophies. Common denominators and particularly effective methods or styles will be highlighted. Scheduled to be released in January.	Orders being taken by SIA Publications Dept. Non-participating firms: $275 Non-member firms: $550
"RR Perspectives '85: Retail Registered Representatives and the Securities Industry"	Results (Part 1) of RR survey focusing on overall picture of "typical" broker. For example, the typical broker has 314 accounts in his book, follows 24 companies closely, and makes 17 cold calls a day.	Registered Representative December 1985
Committee Report on "Tax Reform Act of 1985"	Contains background, summary, revenue and budget effects, explanations of all provisions and dissenting views.	Bureau of National Affair's Customer Service Center 9435 Key West Ave. Rockville, MD 20850 2 - Parts, $15 each
"The Expenditure Tax Option"	Concern over the impact of tax reform on the competitiveness of the U.S. in world markets, insistence on revenue-neutral tax reform, and the need for deficit reduction have placed new emphasis on consumption or expenditure tax options. Article reviews four bills based on these concepts, including Roth's business transfer tax.	The Journal The Institute for Socioeconomic Studies Quarterly publication
"1985 Euro-Bond Ranking"	Top 25 book managers ranked. Credit Swisse First Boston holds first place in Eurobond debt offerings, accounting for $19.3 in book-run deals.	Investment Dealer's Digest 1/6/86

"Tax Reform & Financial Markets" "Tax Reform, Interest Rates and Capital Allocation"	Two working papers reviewing the impact of Treasury I and II, Bradley-Gephardt and Kemp-Kasten. The first paper compares and contrasts the likely impact of each of these four proposals on interest rates for taxable and tax-exempt issues, flows to different securities, and stock prices. The second paper reviews the proposals' effects on the level of interest rates and the allocation of capital among nonresidential capital, rental housing and owner occupied housing.	Working Paper no. 1707 & 1708 National Bureau of Economic Research 1050 Massachusetts Ave. Cambridge, MA 02138
"Deals of the year - hits, misses and curiosities"	Summary thoughts on all three types of deals, from company as well as banker. Example "hit": IPO of Fireman's Fund Corp. Example "miss": 3 debt offerings by Kmart Corp.	Institutional Investor December 1985
"Rating Advisers"	Summary of the Hulbert Financial Digest's annual report on investment advisers. 73 newsletters ranked by change in portfolio.	Barron's 1/13/86
"Where to Invest in 1986"	Double issue containing 78-page forecast of prospects for various investments, ranging from stocks to art, in 1986. Notable quote: Analysts expect the bull market to last for years.	Business Week 12/30/85
"Recent Developments in the Bankers Acceptance Market"	Traces the rapid expansion of the dollar-denominated bankers acceptance market through the 1970s and early 1980s and the subsequent contraction of this market beginning in early 1983. Article concludes that market may very well continue to contract, given the proliferation of attractive substitutes as a result of financial innovation and deregulation.	Federal Reserve Bulletin January 1986